

20 December 2017

Chief Executive
External Reporting Board
PO Box 11250
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Via email submissions@xrb.govt.nz

Dear Warren

SUBMISSION ON AUDIT OF SERVICE PERFORMANCE INFORMATION EXPOSURE DRAFT

Overall Comments

Thank you for the opportunity to comment on the exposure draft (ED) NZAuASB 2017 -2 New Zealand Auditing Standard XX *The Audit of Service Performance Information*.

We support the development of a domestic auditing standard dedicated to service performance information, with separate development of a review engagement standard at a later stage. We consider that a dedicated auditing standard will help reinforce the need to undertake the audit of the service performance information and the audit of the financial statements in a concurrent manner.

Overall, we consider that the high-level, principles based approach taken in the ED is appropriate. We commend the NZAuASB for the quality and depth of the application guidance and illustrative examples included within the ED. These will be instrumental in assisting auditors to apply the new standard.

We are particularly supportive of the two-step approach to the audit of service performance information and consider that the audit report should include explicit opinions on each of these steps. In our view this will help reduce the expectation gap and may rebalance the roles of preparer (responsible for adopting suitable criteria) and the auditor (responsible for assessing the suitability of this criteria).

Detailed Comments

We have included our responses to the specific questions raised in the Invitation to Comment (ITC) in Appendix 1 and more minor editorial comments in Appendix 2. Information about the Staples Rodway network is provided in Appendix 3.

We hope the comments contained in our submission are useful. If you would like to discuss any of these comments please contact Nicola Hankinson, National Technical Manager, at nicola.hankinson@stapleswellington.co.nz.

Kind regards



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Appendix 1: Responses to specific questions in the Invitation to Comment

General

1. Yes, we agree with the proposed approach of developing an auditing standard rather than a standard under the umbrella of ISAE (NZ) 3000 (Revised). We consider this is an important signal that the audit of service performance information is of equal nature to the audit of the financial statements, and that, as such, these should be undertaken concurrently. On a practical level it will also be helpful to auditors to consider only one set of standards when undertaking an audit engagement where service performance information forms part of the engagement scope.
2. We consider that the ED is understandable and scalable. However we do consider there is scope to reduce the amount of information from other auditing standards that is included in the ED. The references that we consider could be removed are: The Auditor's Responses to Assessed Risks (paras 39 – 42), Audit Considerations Relating to an Entity Using a Service Organisation (para 43), Evaluation of Misstatements Identified During the Audit (paras 44 and 45) and Special Considerations – Audit of Groups (para 53).

We do not consider that the approaches to applying these standards in the course of the financial statement audit and the audit of service performance information are different enough to require their inclusion in the standard. Para 8 of the ED makes it clear that the auditor shall apply all the ISAs (NZ) as appropriate.

3. We consider the ED contains useful guidance to assist auditors in auditing service performance information. In particular we consider that the guidance on assessing materiality for service performance information and determining materiality factors (A41) of the ED will be useful in applying the ED. Given its usefulness we encourage the NZAuASB to consider including some of the guidance on assessing materiality (specifically the characteristics of suitable criteria included in para A17 of the ED) in the standard itself (para 31). This will help to ensure that the standard 'stands alone' and will ensure consistency in assessing materiality between auditors and audit firms. We acknowledge that the qualitative characteristics have been included in para 58 of the ED (under 'forming an opinion and reporting'). It would be beneficial to introduce the qualitative characteristics in an earlier section of the ED (ie when introducing the assessment of the suitability of the criteria in para 12, rather than referring auditors to the PBE Conceptual Framework).
4. While the high-level, principles based nature of the ED goes a long way towards balancing consistency and quality of an audit that includes service performance information there appears to be significant reliance on the use of professional judgement. In our opinion this reliance will impact on the consistency of the audits of service performance information and will also require greater use of senior time on these engagements. It would be useful if additional guidance or direction could be incorporated in the standard so that the degree of professional judgement required is reduced. One example would be to make more explicit reference in the auditing standard to the disclosure of judgements section required in para 44 of FRS -48 *Service Performance Information*. In our view, this is the key requirement in the financial reporting standard that places the onus on the preparer (management and TCWG) to make judgements regarding what should be reported, and what level of detail is appropriate. Greater emphasis on gaining comfort around this section should help to rebalance the roles of preparer and auditor.
5. Yes, we consider that the ED is clear in emphasising the concurrent nature of the audit. Refer to our response to question 1 above.

Suitable service performance criteria

6. We suggest that the definition of service performance criteria could be shortened to improve its readability and understandability as follows:

"the benchmarks used to measure or evaluate the entity's service performance. These ~~entity's service performance criteria~~ include the goods and services ~~reported delivered~~ and related performance measures and/or descriptions ~~used for the particular engagement adopted by the entity~~, applicable to ~~the entity and its circumstances~~, ~~with logical links which link~~ to the entity's overall purpose and strategies, in accordance with the applicable financial reporting framework".

Given the importance of the term 'service performance information' and its use throughout the ED, we consider it would be useful if the standard also defined this term. We note that there is some discussion of what service performance information is, and isn't, and what references to service performance information should be considered to include in A2 and A8 of the ED. While this is useful, it would be more useful to define service performance information in the standard itself.

7. We agree that the two-step approach taken in the ED, in particular the requirement for the auditor to first evaluate the suitability of the entity's service performance criteria, and secondly obtain sufficient and appropriate audit evidence to support the service performance information, is appropriate. We consider that it would be useful to include both of these steps in the audit report itself to make this distinction clear to users. It may also be useful to make it clear that step two builds on step one (ie the reported information should link back to the criteria selected by the entity and assessed as suitable by the auditor).
8. Yes, we consider the ED is clear in this regard. In terms of further clarification, it may be worth including a statement in the ED acknowledging that additional selection bias may be introduced where the entity makes changes to its service performance criteria during the financial year. We consider that, on balance, it is important to allow entities to make changes to these criteria during the year, as many entities will be working to improve their service performance frameworks and may be taking into account feedback received from their auditors at the start of the financial year (in line with para 14 of the ED).
9. As noted in question 4 above, we consider that explicit reference to the disclosure of judgements section in FRS-48 would go some way to linking the requirements of the auditing standard with the requirements of the financial reporting standard. While we acknowledge that the application material refers to the disclosure of the critical judgements (A28), it would be useful if explicit reference was included within the standard itself.
10. Yes, we consider the ED includes useful guidance to assist auditors in assessing the suitability of the criteria. In particular, we consider the application material discussing the degree to which the criteria exhibit the qualitative characteristics in A15 to A28 will be useful to auditors.
11. Assessing the suitability of criteria is a relatively unfamiliar concept for auditors given the financial reporting frameworks used in New Zealand are more well-defined than the frameworks for service performance reporting. As such the additional explanatory guidance and illustrative examples will be well received.

We consider the ED places good emphasis on the need for auditors to exercise professional scepticism in assessing the suitability of the criteria, given the risk of management bias in selecting these criteria. One suggestion we have for enhancing the application of professional scepticism in audits of service performance information is to make explicit a rebuttable presumption of the risk of material misstatement relating to the selection of suitable criteria. This could be done in a similar way as was done for the risk of material misstatement relating to fraud in revenue recognition (para 26 of ISA (NZ) 240). It may be useful to use terms (such as rebuttable risk of material misstatement) that auditors are already familiar with through existing ISA's. We consider including an explicit risk of material misstatement (RMM) in the ED will enhance the level of scepticism applied in assessing the criteria selected by TCWG. Application guidance around instances in which this risk could be rebutted could include where the criteria are specified by an external entity, grant etc or where the strategy of the entity is so distinct that the selection of a single performance measure is deemed appropriate.

In order to provide a more balanced approach, the NZAuASB may consider it is appropriate to apply the rebuttable presumption of RMM in defined instance, such as where:

- The entity is reporting service performance information for the first time
- There has been a change in the suitable criteria
- There has been a significant change in the entity's operations.

Assertions

12. We consider that the identified assertions are appropriate, in particular the inclusion of the attribution assertion. In terms of structure of the ED, we consider it would be useful if the assertions were included in the body of the ED itself (para 38), rather than the application material (para A49). We acknowledge this is a departure from the approach applied in ISA (NZ) 315 (Revised) however we consider that this departure is justifiable on the basis that

the assertions are a critical part of determining the audit approach, and that auditing service performance information is a new subject matter for a number of auditors. As such, it would be useful to make the standard as clear and complete as possible by including the assertions that auditors should seek comfort over.

We note that ISA (NZ) 315 (Revised) includes a 'substance over form' statement in para A128 relating to the use of assertions. It would be useful to include such a statement in the service performance information standard as well.

13. We note the discussion in para 43 of the ITC around the impact of absent or weak controls on the audit approach and the auditor's opinion. We agree that, particularly while the NFP sector are developing the processes and controls around service performance information, a more substantive approach to the audit is likely to be required. We are mindful that this may have an impact on the cost of undertaking an audit over service performance information, and that this cost is unlikely to be able to be fully recovered from the entity itself.

Use of experts and other practitioners

14. We consider that the ED adequately addresses the use of experts by signposting to the requirements of ISA (NZ) 620. We do not consider that additional application material is required.
15. We consider that the ED adequately addresses the use of another practitioner by signposting to the requirements of PES 1 (Revised). We do not consider that additional application material is required.

Reporting

16. We consider that inclusion of an explicit opinion on whether the criteria selected by the entity are suitable (as outlined in EG Aug and para 56 of the ITC) within the audit report would be useful. We recognise there is a trade-off between keeping the audit report simple and understandable and providing enough information on the work undertaken to enable users to understand the audit. We consider that inclusion of an explicit opinion regarding whether the criteria have been assessed as suitable would assist with users understanding the level and nature of work undertaken by the auditors, without greatly extending the size of the audit report.

We consider that the audit report should not include information as to why the auditor considers that the service performance criteria are suitable. An explanation of why the auditor considers that the service performance criteria are suitable may risk giving the impression that the auditor has had a role in selecting this criteria. Such disclosure is also unlikely to add information value to the readers of the audit report and may quickly become 'boilerplate'.

In our view the financial report itself should describe the entity's service performance criteria and their sources' (if required by the financial reporting framework). The audit opinion would then cover these disclosures. If there is no requirement for preparers to disclose the criteria used or their sources then we do not consider it would be appropriate to require the audit opinion to disclose these criteria on behalf of the entity.

We consider that underlying facts or findings or recommendations related to the suitability of the service performance criteria are best included in the management letter (reporting to TCWG). This is in line with the approach taken in the audit of the financial statements, that no new information is introduced in the audit report¹.

17. We consider that users of the auditor's report may benefit from the inclusion of additional information in the auditor's report, such as an overview of the scope of the audit work undertaken in relation to service performance information. In our view this may assist users in understanding the respective roles and responsibilities in relation to this information. It may also help bridge the 'expectation gap' that often arises between preparers and auditors. To some extent information on the audit process is provided to users as part of the 'auditors responsibilities' section. However, this information is generally quite generic, rather than tailored to the individual engagement. We consider it would be more useful if a high-level overview of the audit procedures performed were separately

¹ Para A36 of ISA (NZ) 701 states that auditors should 'seek to avoid the description of a key audit matter inappropriately providing original information about the entity'. The same theory could equally be applied to the audit opinion avoiding providing new information regarding service performance information.

described under the Basis for Opinion section as is done with assurance reports provided in accordance with ISAE (NZ) 3000, *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*.

18. We agree that the ED should allow for flexibility rather than be prescriptive with respect to whether a short form or long form audit report should be provided. While a long form report will provide more information to users and help develop users understanding of the audit process it will not help with the scalability of the ISA (NZ)'s and is likely to lead to increased compliance costs and the inclusion of boilerplate disclosures. As such we support the requirement for a short form report, with the ability to include a longer form report if users demand it.
19. As stated in 16. above, we consider it would be useful for the auditor to explicitly opine on the suitability of the entity's service performance criteria. In our view this will help communicate to users the role of the auditor and may help confirm that TCWG are responsible for establishing the criteria which the service performance information has been reported against.
20. No, as noted in 18. above, we consider it is preferable to provide an explicit statement in the opinion regarding the suitability of the entity's service performance criteria.
21. We consider that the two-part opinion will be better understood by users as this provides clarity regarding the two-step approach to auditing service performance information. There is a danger that users will not easily understand implied opinions. Making the opinion over the suitability of criteria selected by TCWG explicit also enables the auditor to modify the audit report at this stage of the process.
22. We have not identified any additional factors that should be described in the description of responsibilities of TCWG.
23. We have not identified any additional factors that should be described in the auditor's responsibilities section.
24. In our view the ED provides useful explanation and illustrative examples regarding the implications in the event the auditor determines it is necessary to modify the opinion in respect of service performance information. This explanation and the corresponding illustrative examples will need to be updated should the NZAuASB agree it is appropriate to include an explicit opinion regarding the suitability of criteria adopted.
25. We agree that aligning the effective date with the proposed Tier 1 and Tier 2 PBE accounting requirements is appropriate. There is a risk that PBE's, particularly NFP's who have not previously reported service performance information within their financial report, may not have a sufficiently well-developed service performance framework, suitable criteria or adequate systems and processes for collating and reporting service performance information, when the financial reporting standard becomes effective. As a result, the first year of adoption of the financial reporting and corresponding auditing standard may see an increase in the number of modified audit reports. We consider this risk is outweighed by the importance of ensuring that the information provided is subject to a reasonable level of assurance so that users can have confidence in this information.
26. In terms of the development of a review engagement standard, the key area of difference we foresee is the reporting section, given the different levels of assurance provided. For the review engagement report we do not consider it would be necessary to make the auditor's opinion over the suitability of the service performance information criteria explicit. The review engagement report could be along the lines of '*nothing has come to our attention to suggest that the service performance framework is not appropriate or that the disclosures are not fairly stated*'.
27. We identified some minor editorial issues and have included these in Appendix 2.

Appendix 2: Editorial comments

Page number (ITC)	Para reference	Description
28	Para 21	Suggested changes to second sentence to better articulate the concurrent approach to auditing financial and service performance information: <i>'...together with and the service performance information so that the audit is performed in the most effective manner and reflects <u>the any correlation with the audit of the financial statements</u> between this information and information obtained as part of the audit of the financial statements.'</i>
29	Para 26	Insert [for the audit of the financial information] between 'determining performance materiality' and 'as required by ISA (NZ) 320'.
33	Para 51	Suggested changes to second sentence to better articulate the concurrent approach to auditing financial and service performance information: <i>'The auditor shall <u>also request ensure the</u> written representations from those charged with governance <u>with includes explicit confirmation of their</u> appropriate responsibilities for their service performance information and knowledge of the matters concerned'.</i>
35	Para 58	Include Para 58 (regarding assessment of suitability of criteria) before para 57 (regarding conclusion on level of assurance and audit evidence obtained) (to reflect the chronological nature of these steps).
41	A10	Insert [audit of] between 'ISAE (NZ) 3000 (Revised) to the' and 'service performance information'

Appendix 3: About Staples Rodway

Staples Rodway is an association of independent accounting firms, located in Auckland, Waikato, Tauranga, Hawke's Bay, Taranaki, Wellington and Christchurch. Staples Rodway is a full service accounting and business advisory firm with a strong reputation for providing quality advice to privately owned, corporate and public sector organisations. With 51 partners and more than 400 professional & support staff operating across its seven offices, Staples Rodway is the 7th largest accounting firm in New Zealand.

Staples Rodway provides cross-border services through our international affiliated firms, including Pitcher Partners in Australia and the Baker Tilly International network.